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S E C R E T AMMAN 004697

SIPDIS

TREASURY FOR OASIA

E.O. 12958: DECL: 08/20/2007
TAGS: EFIN ETRD JO
SUBJECT: JORDAN CENTRAL BANK GOVERNOR WORRIED ABOUT BANKS' EXPOSURE TO OIL FOR FOOD TRADE

Classified By: Ambassador Edward W. Gnehm. Reasons 1.5 (b) and (d)

¶1. (S) Summary. Jordan's central bank governor is worried that a sudden interruption in Oil for Food exports via Jordan to Iraq in the event of military action in Iraq could leave the Jordanian banking system seriously exposed. He requested U.S. views on possible mechanisms that would help banks cope with this problem. Jordanian ministries are working on an assessment of the likely economic fallout of a disruption in trade with Iraq, which, the governor expects, would be difficult, but manageable at a high cost. End Summary.

¶2. (S) Central Bank Governor Umayya Touqan told econ chief August 19 that an inter-ministerial group led by the finance ministry at the behest of the Prime Minister is working on economic planning for managing the fallout on Jordan of a possible military strike on Iraq. He said the group was preparing a short paper, which should be forwarded to the U.S. and other governments soon.

¶3. (c) One area of specific concern to the Central Bank that Touqan said he had discussed with the Prime Minister (who had also raised it with the Ambassador) is the exposure of Jordanian commercial banks to UN Oil for Food program exports to Iraq. At any one time, Touqan said, Jordanian banks have USD 400-500 million in letters of credit outstanding to finance this trade. Under current procedures, UN officials in Baghdad confirm receipt of goods in Iraq before BNP as the bank managing the oil for food account releases payment for OFF contracts to Jordanian banks. If this system were unable to function because of military activity, Jordanian banks could be left holding the bag.

¶4. (c) Touqan said that the USD 400-500 million estimated in outstanding Jordanian bank credit is concentrated in and makes up a substantial part of the assets of 4-5 Jordanian commercial banks. He did not think these banks, or by extension the banking system as a whole could absorb the shock of having so much liquidity tied up in the event of an extended conflict.

¶5. (c) Two possible mechanisms for dealing with this had occurred to Jordanian officials: 1) UN inspectors could be stationed at the Jordan-Iraq border to take control of incoming goods. In this case, banks could be paid and goods could be held at the border until delivered to their ultimate destination. 2) Alternatively, goods could be stored in Jordan with the Jordanian banks keeping or acquiring title to them. This would allow the banks to use the goods as security in order to raise funds. Touqan said that there were no doubt other ways to deal with this problem and would appreciate the U.S. government's opinion.

¶6. (c) Overall, Touqan described the impact on Jordan of a disruption in its trade with Iraq as difficult, but ultimately manageable. He said the central bank would act aggressively by raising interest rates to counter any inflationary tendencies arising from a likely increase in the government deficit. This would result from the expected loss of the Iraq oil grant, a drop in tax revenue due to a contraction in economic activity, and increased emergency spending to help companies and individuals cope in such a crisis. At the same time, remittances, export earnings, and tourism receipts would drop sharply. Jordan would use its resources, including its foreign reserves, but obviously, Touqan said, the more quickly military action was over, the easier it would be for Jordan to absorb such a massive shock.

¶7. (S) Comment: Touqan, an economist and former diplomat, is not prone to dramatization; but the scenario he paints sounds like a recipe for shutting down the financial system for possibly an extended period. We would appreciate being able to convey to him and to the Prime Minister Washington's views on the issue Touqan raises.
GNEHM